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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company, San Diego Gas & Electric Company and Southern California Edison Company for Approval of Changes to Natural Gas Operations and Service Offerings.	)))))))	A.06-08-026 (Filed August 28, 2006)

**COMMENTS OF SOUTHERN CALIFORNIA GAS COMPANY
AND SAN DIEGO GAS & ELECTRIC COMPANY
ON PROPOSED DECISION OF ALJ PULSIFER**

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COMMENTS OF SOUTHERN CALIFORNIA GAS COMPANY AND SAN DIEGO GAS & ELECTRIC COMPANY ON PROPOSED DECISION OF ALJ PULSIFER

Southern California Gas Company ("SoCalGas") and San Diego Gas & Electric Company ("SDG&E") hereby submit comments in response to the Proposed Decision ("PD") of ALJ Pulsifer issued November 5, 2007.

I. GENERAL RESPONSE

SoCalGas and SDG&E support the provisions in the PD adopting Applicants' proposals and declining to adopt contrary proposals by intervenors such as Coral. Certain portions of the PD, however, change the provisions from the Continental Forge and Edison settlements in ways we never envisioned, and never would have agreed to. Certainly, if SoCalGas had thought that agreeing with Edison to resolve past differences would have resulted in a $5 million cap on shareholder earnings from unbundled storage, we likely never would have included storage-related provisions in our settlement with Edison, and perhaps would not have even settled at all.

SoCalGas and SDG&E should not be punished for agreeing to propose a new $20 million cap on unbundled storage revenues through imposition of a cap that is only ¼ as large; GCIM shareholder rewards should not be reduced just because we have proposed to make permanent existing Commission policy with respect to winter hedging; the new System Operator hub should not be subjected to restrictions that threaten to nip in the bud any potential for success the new hub might otherwise achieve; and core storage set-asides should not be changed from the carefully-negotiated numbers agreed to in the Edison settlement.

Instead, for the reasons set forth below and in our briefs, testimony, and application, SoCalGas and SDG&E respectfully request that the Commission revise the PD to make it consistent with the entire balanced and unified package of proposals presented by SoCalGas, SDG&E, and Edison (collectively "Applicants").

II. THE ANNUAL CAP ON UNBUNDLED STORAGE EARNINGS SHOULD BE $20 MILLION, NOT $5 MILLION

The PD appropriately maintains market-based pricing for unbundled storage.[1] The PD's imposition of an interim $5 million cap on shareholder earnings,[2] however, does not represent sound regulatory policy.

The PD reiterates SCGC's assertion that ratepayers have received only $6 million in storage revenues since 2000, while shareholders have received $89 million.[3] These figures present a fundamentally inaccurate picture. Customers and shareholders have shared unbundled storage revenues on a 50/50 basis since 2000 as a result of the 1999 BCAP decision. As a result, customers received $89.7 million in unbundled storage revenues since 2000, not $6 million.[4] Customers did pay a total of $83 million over that same time period for non-storage-related scalar charged to them 100% as a result of the 1999 BCAP decision.[5] But customers would have paid

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[1] PD at 67-68.
[2] PD at 68.
[3] PD at 67.
[4] Ex. 9 (Watson) at 4.
[5] Id. at 4, 18-20.

for this scalar whether or not they received any unbundled storage earnings.[6] So it is inappropriate to subtract the scalar from our customers' share of unbundled storage earnings and then act like such earnings were never received by customers.

The $5 million earnings cap proposed by the PD would have a dramatic negative effect on our existing incentives. In effect, any effort or expenditure beyond that necessary for SoCalGas to earn $10 million from the unbundled storage program ($5 million going to customers and $5 million going to shareholders) would not be beneficial to SoCalGas from a financial standpoint. Assuming that the value of storage remains strong enough to get us to the $10 million total earnings mark each year, any additional dollars we would spend on marketing efforts or expansions would actually decrease shareholder earnings -- since we would be spending more to achieve exactly the same level of shareholder reward. Clearly, there would be no incentive to engage in additional marketing activities or to create additional storage assets with such a cap, unless the value of storage assets in the competitive marketplace plummets precipitously.

The PD notes that Applicants have presented evidence that a $5 million cap on shareholder earnings is not a sufficient incentive for SoCalGas to expand storage capacity, and that such a cap would, in effect, approximate zero shareholder earnings over the long term as a result of periodic adjustments in each BCAP.[7] But the PD fails to do anything with this unrebutted evidence, other than stating that a $20 million cap "has not been justified."[8] This is not a reasonable basis for such a substantial change in longstanding Commission policy. The Commission should keep in mind that Applicants are not asking to increase an existing cap or otherwise increase shareholder earnings. The status quo, which was justified to the Commission's satisfaction back in 2000, is 50/50 sharing with no cap on shareholder earnings. The question for the Commission should be

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[6] See PD at 66.
[7] PD at 67. See also Ex. 9 (Watson) at 8, 23-24.

whether the new $20 million earnings cap proposed by Applicants is a reasonable change to the current approved policy of no cap whatsoever, not whether the annual shareholder earnings cap should be $20 million, $5 million, or something in between.

Our existing unbundled storage incentives have helped create a strong and vibrant unbundled storage program in Southern California. Without such incentives, would customers have received unbundled storage refunds of anything close to $89.7 million over the last several years?[9] Would SoCalGas have expanded its storage inventory capacity from 105 Bcf to 131 Bcf? Almost certainly not. Furthermore, the very low unbundled storage earnings cap proposed by the PD could encourage SoCalGas to favor System Operator hub transactions rather than unbundled storage transactions once $10 million in earnings from unbundled storage has been achieved. The Commission should not take a successful program and bludgeon it into a shadow of its former self through imposition of an inappropriately low incentive, even on an interim basis. If the Commission believes the balance between customers and shareholders established by the 1999 BCAP decision should be adjusted to reflect a subsequent change in the market value of storage, the change should be incremental – like the carefully crafted changes to SoCalGas' GCIM and SDG&E's gas procurement PBR mechanisms over the years.

SoCalGas should not be punished for settling our differences with Edison in a way that attempts to proactively address Edison's concerns regarding our unbundled storage program. SoCalGas should not be penalized for proposing a new customer-friendly unbundled storage revenue cap between BCAPs through imposition of an unbundled storage earnings cap only ¼ the size of the one we proposed. If the Commission ratifies the PD's $5 million unbundled storage earnings cap, SoCalGas would have been much better not settling with Edison at all. Instead, we

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[8] PD at 68.
[9] Ex. 9 (Watson) at 4.

should have continued with the longstanding Border OII litigation, and fought to have the Commission finally take a look at the conduct of companies other than Sempra and its utility subsidiaries during the 2000-2001 energy crisis. If we had not settled with Edison, the Commission likely would not have seriously considered changes to SoCalGas' unbundled storage program until the next BCAP. The downside in additional litigation costs and further lost time we would have faced from additional litigation with Edison is miniscule compared to the likely $30 million + hit shareholders will take over the next two years if the PD's $5 million unbundled storage earnings cap stands. Moreover, any new limits on shareholder earnings adopted in the BCAP would likely be somewhat offset by updated unbundled storage capacity allocations and costs – a feature necessarily absent from the PD.

The $20 million annual earnings cap proposed by Applicants is a reasonable and appropriate incremental change to SoCalGas' unbundled storage program. Such a cap would prevent shareholders from receiving "windfall" earnings during those limited instances when the value of unbundled storage substantially exceeds its cost. Yet the cap would be high enough to encourage innovative, customer-friendly storage product offerings, strong marketing efforts by a dedicated SoCalGas team, and continued synergistic storage expansions like those that SoCalGas has recently undertaken. SoCalGas and SDG&E respectfully request that the Commission adopt the $20 million annual cap on shareholder earnings from unbundled storage proposed by Applicants, and decline to adopt the interim $5 million cap proposed by the PD. Much of the PD is well-reasoned and logical. The PD's $5 million interim cap on shareholder earnings from unbundled storage, however, is not appropriate for all of the reasons just described.

III. HUB REVENUES SHOULD BE SHARED 50/50 WITHOUT ANY ANNUAL CAP

The PD imposes -- on an interim basis -- an annual cap on System Operator hub revenues of $5 million, with 80/20 sharing rather than the 50/50 sharing proposed by Applicants.[10] These limits, although certainly better than suggestions from certain intervenors, do not represent the best potential policy with respect to this new hub. Hub services use uncontracted or unutilitized assets, and maximizing the use of those assets will benefit all of our end-use customers through reduced rates – including many customers who never use hub services.[11] As with unbundled storage, we believe there will be significantly more hub revenues to share with ratepayers under a 50/50 mechanism than there would be under a 90/10 mechanism.

A 50/50 split of hub revenues would create symmetry with Applicants' proposed split of unbundled storage revenues, and ensure that SoCalGas has no incentive to favor one type of service over the other. Moreover, 50/50 sharing would be closer to the PG&E model (PG&E shareholders receive 100% of all PG&E hub revenues)[12] than the 80/20 split proposed by the PD. Although the PD doesn't say so explicitly, the 80/20 split of hub revenues may be designed to mirror the 80/20 GCIM sharing also proposed by the PD. This treatment fails to recognize that the System Operator hub will be brand new, and will be competing with a new unbundled storage secondary market created by SoCalGas as a result of the CF settlement. When the GCIM first started, it had 50/50 sharing.[13] Later revisions to sharing percentages came about incrementally, as a result of fine tuning in consultation with DRA and TURN. The imposition of mature GCIM-style limits on a fledgling hub would not be appropriate. All customers have a vested interest in

[10] PD at 42.
[11] Ex. 31 (Schwecke) at 4.
[12] See D.97-08-055, mimeo., at p. 39 of Appendix B.
[13] See D.02-06-023, mimeo., at 2.

the development of an active and vibrant System Operator hub. Limiting the upside potential of the new hub in the manner proposed by the PD may fundamentally stunt such development.

Furthermore, the PD's $5 million cap on annual hub revenues is potentially even more onerous than the imposition of 80/20 sharing. Capping potential earnings at this relatively low level sends a clear signal to SoCalGas that the new System Operator hub should not be a priority. Plus, if 80/20 sharing for hub revenues is designed to mirror GCIM sharing, the Commission should keep in mind that procurement activities under the GCIM (including hub activities currently within the GCIM) are not subject to such a low cap.

Applicants' proposal for 50/50 sharing of hub revenues with no cap represents the best potential regulatory policy for the new System Operator hub. If the Commission believes there is uncertainty regarding the appropriate level of sharing of hub revenues, that uncertainty should be resolved, at least initially, in favor of a more generous sharing policy to help insure that the new hub becomes a priority for SoCalGas. Once the hub is on its feet and we have obtained experience with its operations, the Commission can always revisit hub revenue sharing provisions to see if they remain appropriate, just as it has done with the GCIM over the years.

IV. GCIM REVENUES SHOULD CONTINUE TO BE SHARED 75/25 BETWEEN CUSTOMERS AND SHAREHOLDERS

The PD revises the GCIM ratepayer/shareholder risk sharing allocation from 75/25 to 80/20 as proposed by DRA to reflect the reduced risk to shareholders due to the assignment of 100% of winter hedge costs to ratepayers.[14] This revision to the GCIM ratepayer/shareholder risk allocation is not justified.

In D.05-10-043, the Commission first authorized SoCalGas and SDG&E to remove winter hedging costs from their gas procurement incentive mechanisms. In that proceeding DRA (then

ORA) argued that if the Commission was going to take such a step, it should entirely suspend the incentive mechanisms for the 2005-2006 period.[15] The Commission declined to do so, noting that the additional winter hedging proposed by the utilities and attendant costs "will provide core customers of SoCalGas and SDG&E with the proper amount of protection for potential winter price runups while maintaining just and reasonable rates."[16] The next year, DRA proposed a different approach, arguing for inclusion of 25% of winter hedges within the mechanisms and 75% outside of the mechanisms. The Commission once again declined DRA's suggestion to alter the utilities' gas procurement incentive mechanism to compensate for moving winter hedges outside of the mechanisms:

> We find that the existing incentive mechanisms may not be designed to accommodate hedging activities that might be reasonable given changing market conditions. The utilities make a reasonable case that they may not be able to justify the shareholder risk that could be implicated if they were to engage in an optimal amount of hedging within their respective incentive mechanisms. The utilities have generally opposed increasing the tolerance bands for their incentive mechanisms on the basis that the change could reduce their prospects for shareholder awards. TURN agrees with this rationale.
>
> In line with D.05-10-015, D.05-10-043 stated '…we should not put SoCalGas and SDG&E in a position in which their purchasing of additional hedging instruments to protect core customers could result in large financial penalties for their shareholders.' The record here provides little analysis of the potential impacts of increasing the tolerance bands under different scenarios and in light of our past decisions rejecting the increase in tolerance bands in the utility incentive mechanisms, we see no reason to do so now. For this reason, we reject DRA's proposal of a "compromise hybrid approach" whereby 25% of the hedges would be included in the incentive mechanisms, with the remaining 75% to be allocated outside of the incentive mechanisms.[17]

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[14] PD at 46 and 101.

[15] D.05-10-043, mimeo., at 13.

[16] Id. at 14 (citation to D.05-10-015 omitted).

[17] D.06-08-027, mimeo., at 14. This decision dealt with hedging for the 2006-2007 winter season. D.07-06-027 (SoCalGas) and D.07-07-011 (SDG&E) authorized the utilities to engage in winter hedges outside of their respective

There is no justification for the PD's reversal of the clear and consistent policy established by these recent Commission decisions. SoCalGas and SDG&E are not reducing shareholder risk when they engage in winter hedges outside of their gas procurement incentive mechanisms. Rather, we are responding to the higher prices and volatility we have seen over the past several years with transactions that were never contemplated to be included within the mechanisms. Put another way, these are hedges that we would not otherwise undertake. If the Commission does not want SoCalGas and SDG&E to engage in "insurance-type" hedging, it can say so. All of our other procurement-related activities will go on with little or no change. But the utilities' potential for shareholder reward under the GCIM should not be reduced just because we are entering into "insurance-type" hedges that the Commission, at least up to now, appears to approve of wholeheartedly.

V. THE REGULATORY TREATMENT OF SDG&E'S 2007-2008 WINTER HEDGE PROGRAM SHOULD NOT BE CHANGED

The PD also provides that 80/20 ratepayer/shareholder risk sharing "shall be consistently applied to SDG&E's approved 2007-2008 winter hedge program upon the effective date of that decision."[18] This retroactive application of a new sharing percentage is not proper, and does not make sense. The effective date of D.07-07-011 was several months ago, and SDG&E has already entered into its winter hedges. It would be inappropriate to change SDG&E's sharing percentages after the winter hedges have been entered into. Furthermore, it is unclear how the revised risk sharing percentage would "be consistently applied to SDG&E's approved 2007-2008 winter

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gas procurement incentive mechanisms for the current 2007-2008 winter season. DRA did not propose changing the utilities' incentive mechanisms in either of these two proceedings.

[18] PD at 46 and 101.

hedging program" when D.07-07-011 placed the costs and benefits of the program outside of SDG&E's gas procurement PBR mechanism.[19]

VI. THE CONSOLIDATED CORE STORAGE RESERVATIONS PROPOSED BY APPLICANTS SHOULD BE ADOPTED

The PD rejects the core storage inventory and injection set asides proposed by Applicants (70 Bcf of inventory capacity and 327 MMcfd of injection capacity), and instead requires the combined core portfolio to maintain the existing combined core storage capacities (83 Bcf of inventory capacity and 369 MMcfd of injection capacity).[20] These higher core storage reservations are not necessary, and they would disrupt the careful balance between the interests of core customers, noncore customers, and shareholders inherent in our settlement with Edison.

The PD concludes that the somewhat lower combined core inventory and injection reservations proposed by Applicants would have detrimental effects on core customers.[21] As Applicants have explained, however, SoCalGas and SDG&E can reliably serve their core customers with the lower inventory and injection reservations provided for in the Edison Settlement. The PD notes that Applicants have not presented an analysis of the inventory level which would affect reliability.[22] But Mr. Goldstein has testified that reliability would not be compromised by the combined core reservations of 70 Bcf and 327 MMcfd proposed in our Application.[23] Because we are not proposing inventory and injection reservations lower than 70 Bcf and 327 MMcfd, an analysis of how much lower reservation levels can be decreased would not be relevant.

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[19] D.07-07-011, mimeo., at 8 (Ordering Paragraphs 4 and 5).
[20] PD at 23-29, 100.
[21] PD at 29.
[22] PD at 23.
[23] Tr. at 785, 787-788 (SoCalGas/Goldstein). Dr. Van Lierop provided similar conclusions when asked about the reduced inventory and injection reservations during cross examination. See Tr. at 31-32 (SoCalGas/Van Lierop).

Furthermore, Mr. Goldstein has explained that it is basically a toss-up whether the economic benefit to core of holding the additional inventory and injection rights contemplated by the PD from April of 2002 through March of 2007 would have been worth the cost.[24] According to Mr. Goldstein's unchallenged calculations, in two of the last five years the expected benefit of holding additional storage would have outweighed its cost, and in three of the five years the costs would have outweighed the expected benefit.[25] Given these circumstances, and given the benefit to noncore customers of making additional storage rights available to the unbundled storage program,[26] the somewhat lower core storage inventory and injection set asides proposed by Applicants are both reasonable and appropriate.

VII. OTHER PD REVISIONS TO APPLICANTS' PROPOSALS

SoCalGas and SDG&E support all changes to their operations and service offerings presented by Applicants in this proceeding. Page limitations for these comments, however, prevent us from devoting a separate section to each change to our proposals made by the PD.

A. INTERRUPTIBLE RECEIPT POINT ACCESS REVENUES

Shareholders should receive the limited percentage (10%) of interruptible receipt point access revenues proposed by Applicants (up to an annual cap of $5 million). The PD's denial of this proposal is indeed consistent with D.06-12-031. Both of these decisions, however, fail to recognize that customers will be better off if the utilities have a financial incentive to operate and maintain the system in a manner that maximizes the potential capacity available for the interruptible service and promotes the use of slack capacity through select discounting based on market conditions. Unless the PD is revised, overall revenues for customers will almost certainly

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[24] Ex. 37 (Goldstein) at 6-8.
[25] Id. at 7-8.
[26] See PD at 24.

be less than they would be if the utilities had a limited financial incentive to develop and market this capacity.

Moreover, in D.06-12-031, the Commission recognized that "[t]he availability of interruptible service provides a check on those FAR holders who seek to maximize their financial gain by withholding FAR capacity during a time of need for capacity."[27] Both D.06-12-031 and the PD would leave it up to marketers to seek out these rights.[28] But it does not make sense to relegate a product that could provide a check on the activities of marketers and other FAR holders to the efforts of those same FAR holders. For all of these reasons, the PD should be revised to adopt Applicants' proposal for sharing of interruptible receipt point access revenues.

B. MONTHLY STORAGE TARGETS

The monthly storage inventory targets proposed by Applicants should be approved. These monthly targets respond to concerns raised by the CF plaintiffs, while still enabling Gas Acquisition to plan storage injections in a way that minimizes core's expected gas costs under a wide range of market conditions.[29] SoCalGas and SDG&E can operate under both these monthly targets and a mid-season inventory target, and we have no problem working with DRA and TURN to come up with post-2007 mid-season targets, as the PD directs.[30] However, the new 58 Bcf combined SoCalGas/SDG&E mid-season injection target for 2007 established by the PD should not be adopted. The 2007 injection season is already over, so a new 2007 mid-season injection target is not meaningful. In addition, a combined target would not be appropriate until the core procurement functions of SoCalGas and SDG&E have actually been combined.

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[27] D.06-12-031, mimeo., at 91-92.
[28] PD at 80.
[29] Ex. 2 (Van Lierop) at 2.
[30] PD at 16.

C. ANNUAL CORE PROCUREMENT PLAN

Applicants' proposal for a new annual core procurement plan process should be adopted. Contrary to the conclusion reached by the PD,[31] the process we have proposed is indeed an improvement over existing procedures. Although DRA and TURN do not support the revised procedures, the procedures were important to the CF plaintiffs, and provide parties other than DRA and TURN with more input into our annual procurement planning. Moreover, having the Commission approve our core procurement plans before those activities take place will provide even more certainty that our procurement plans are consistent with the Commission's desires.

VIII. THE COMMISSION SHOULD CLARIFY THAT SOCALGAS AND SDG&E WILL BE ENTITLED TO RECOVER THE COST OF NEW SERVICES AND PROGRAMS APPROVED IN THIS PROCEEDING

Applicants have requested that SoCalGas and SDG&E be authorized to recover from customers the reasonable costs of establishing and maintaining new postings, a secondary market for storage rights, a new fifth nomination cycle, new optional enhanced balancing services, and system expansion studies (plus any related third-party review).[32] The PD approves these particular proposals, but does not explicitly authorize recovery of related costs.[33] Cost recovery may be implicit (e.g., "We hereby approve this proposal as described in the testimony of Mr. Schwecke.")[34] But SoCalGas and SDG&E have been through enough implementation battles to know that clarity on a point like this is important.

No party opposed SoCalGas and SDG&E being reimbursed by customers for these expenses. The new services and programs approved by the PD benefit customers, and there is no

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[31] PD at 38.
[32] Ex. 29 (Schwecke) at 22; SoCalGas/SDG&E Opening Brief at 54, 56, and 59.
[33] PD at 62, 82-85.
[34] PD at 83.

reason for denying us reimbursement of related expenses. Accordingly, the Commission should clarify that SoCalGas and SDG&E will be entitled to recover from customers all reasonable costs of establishing and maintaining the specified new services and programs.

IX. REVENUE REQUIREMENT CHANGES TO REFLECT SAVINGS FROM CONSOLIDATION SHOULD BE MADE IN THE MANNER PROPOSED IN THE SOCALGAS AND SDG&E GRC

The PD directs SoCalGas and SDG&E to reduce, upon implementation of core procurement consolidation, their requested 2008 revenue requirement in their GRC by $2 million to reflect the estimated savings from consolidation.[35] This directive should be clarified to reflect the difference between loaded and unloaded costs, and to recognize that implementation on any date after January 1, 2008, will change the amount of the revenue requirement adjustments.

In their GRC, SoCalGas and SDG&E submitted supplemental testimony describing the adjustments to their respective revenue requirements that would be necessary in the event of core portfolio consolidation. As described in this supplemental testimony (Attachment B to these comments), in the event of consolidation SoCalGas would need to increase its proposed 2008 revenue requirement by $356,000, and SDG&E would decrease its proposed 2008 revenue requirement by $1.531 million. Consistent with the rest of our GRC testimony, these figures are unloaded – i.e., they do not include overheads and escalation. As further explained in our supplemental GRC testimony, when overheads and escalation are included the figures become $459,000 of additional fully loaded costs at SoCalGas and $2.439 million of fully loaded savings at SDG&E. These figures combine to create a total fully loaded revenue requirement decrease of $1.98 million for the two utilities, which is consistent with the "annual savings of approximately

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[35] PD at 20 and 100.

$2 million" described by Applicants.[36] In addition, all of these revenue requirement figures are for a full 12-month year. Since implementation is almost certain to be implemented after January 1, 2008, the figures will need to be revised to reflect the fact that the change will only be for a portion of 2008.

For these reasons, SoCalGas and SDG&E request that the PD be revised to direct them to make the consolidation-related revenue requirement adjustments described in their supplemental GRC testimony, subject to any further changes as may be necessary to reflect implementation of consolidation on a date after January 1, 2008.

X. CONCLUSION

SoCalGas and SDG&E respectfully request that the Commission revise the PD in the manner described above and in the proposed revised findings of fact set forth in Attachment A to these comments.[37]

Respectfully submitted,

By: *\/s\/ Michael R. Thorp*
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[36] Ex. 35 (Goldstein) at 7.
[37] SoCalGas and SDG&E are not proposing any changes to the PD's conclusions of law.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing **COMMENTS OF SOUTHERN CALIFORNIA GAS COMPANY AND SAN DIEGO GAS & ELECTRIC COMPANY ON PROPOSED DECISION OF ALJ PULSIFER** on all parties of record in this proceeding by electronic mail, and by Federal Express to ALJ Pulsifer.

Dated at Los Angeles, California, this 26th day of November 2007.

/s/ Rose Mary Ruiz
Rose Mary Ruiz

CALIFORNIA PUBLIC UTILITIES COMMISSION

Service Lists - Proceeding: A0608026 - Last CPUC Update: November 2, 2007

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